

DOING BUSINESS IN TURKEY: FOREIGN FINANCIAL INSTITUTIONS ENTRY IN TURKISH CAPITAL MARKET

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This briefing note lays out the methods for foreign financial institutions on how to enter into Turkish capital market by staying within its legal boundaries.

I. SOLICITATION FOR FINANCIAL PRODUCTS AND SERVICES IN TURKEY

Decree No. 32 regarding Protection of the Value of Turkish Currency (“Decree”) which was published in the Official Gazette by Council of Ministers dated 11 August 1989 and numbered 20249, is the main piece of legislation that sets forth the regulatory and restrictive principles for all the operations relating to foreign exchange and movement of foreign capital and securities in Turkey. The Decree allows Turkish residents freely to purchase and sell securities and other financial products traded on financial markets abroad as stipulated under Article 15 of the Decree, and to transfer their purchasing proceeds to abroad through banks and intermediary institutions authorized in Turkey.

Besides, Capital Markets Board of Turkey (the “CMB”) interpreted this principle for foreign financial institutions (the “FFI”) that are willing to provide financial service in Turkey or addressed to Turkish residents (real person or legal entity) and set forth that FFIs may provide such service to Turkish residents only if it is provided on an unsolicited basis. This issue, named as reverse solicitation, is more clearly addressed under the Communiqué regarding Principles on Investment Services and Activities and Ancillary services numbered III-37.1. As per the respective legislation; FFIs may offer financial service

or product and may open accounts for the custody of cash or other financial instruments to Turkish residents provided that

- i) such FFI does not engage in any marketing or solicitation activities, either directly or indirectly, in relation to promotion of its services and activities in Turkish borders or addressed to Turkish residents, and
- ii) Turkish residents, with their sole discretion, instruct the FFI at first hand for such service or product on reverse solicitation basis.

As given above, Turkish residents are free to provide financial service or product from a FFI and the FFI may provide its service and product to Turkish resident only on a reverse solicitation basis and consequently, such FFI is forbidden to market, promote or solicit its services or activities in Turkish borders unless licensed by the CMB.

However, FFIs tend to have an appetite for offering their financial products, and services to Turkish residents without establishing any local existence in Turkey. In that respect, such FFI shall bear in mind that if it markets, promotes or solicits its financial products or services in Turkey or sets up an office in Turkey or a Turkish website without being licensed/authorized by the CMB, as set forth under the respective legislation, this will be deemed a violation of capital markets legislation and such entity/responsible person, as per the legislation, may be sentenced to imprisonment from 2 years up to 5 years and a judicial fine from 5.000 days up to 10.000 days. If such FFI earns a profit from these unauthorized/unlicensed activities, the judicial fine is at least double the profit generated.

II. LICENSE REQUIREMENT

CMB requires from any local entity or FFI to provide the requisite license from the CMB before engaging into any financial service or offering any financial product in Turkey. Given this approach, FFIs including banks, brokerage firms, asset management companies, may offer their financial products or services in the territory of Turkey or may engage in capital market activities addressed to Turkish residents only if such entity is granted with the license granted by CMB prior to engaging in such an activity or service. CMB requires such FFI to either offer its services through the intermediation of authorized investment institutions (banks or brokerage firms) in Turkey or establish a local entity (representative office, bank, brokerage firm or asset management company) itself in Turkey in relation to its scope of activity. Once

FFI is granted with the requisite license, this will enable it to market, promote and solicit its activities in Turkey or to Turkish residents.

Pursuant to the Capital Markets Law No. 6362 (the “Law”), services and activities defined below shall be classified as “capital market activities” subject to prior licensing by the CMB:

- i.** Purchase and sale of capital market instruments (i.e. brokerage services);
- ii.** Asset management service;
- iii.** Investment advisory service;
- iv.** Underwriting of capital markets instruments on a firm commitment basis or placing of capital markets instruments without a firm commitment basis; and
- v.** Limited and general custody service.

Each capital market activity requires the FFI to be licensed to provide such activity and to comply with certain licensing requirements. In this sense, FFI may either opt for establishing a local entity in Turkey by complying with these licensing requirements stipulated under the respective legislation or may cooperate with the existing local entities in Turkey to offer its product or service.

III. SETTING UP A LOCAL ENTITY

Pursuant to the Law, banks, brokerage firms and asset management companies are the main type of entities that may provide capital market service in Turkey subject to the rules and restrictions set forth under the Law and respective legislation. Based on this ground, FFIs may, as a first option, consider to directly incorporate a new company in the form of a bank or a brokerage company or an asset management company or set up a branch in order to offer their products and services in Turkey. For this, FFI is required to make the necessary filings to Ministry of Trade and the CMB for obtaining the approval of the authorities for such incorporation and provision of the respective investment service. Once the FFI obtains the approval of the foregoing authorities, then, such entity will be able to perform the intended

capital markets activity in Turkey and market, promote or make solicitation of such activities or products to Turkish residents.

A second option is to set up a representative office in Turkey again subject to CMB approval and other legal requirements envisaged under the respective legislation, which, however, will be less attractive for FFIs as representative offices are not entitled to engage into any commercial activities in Turkey. Further, the representative office of a foreign bank in Turkey may act only within a limited business scope as clearly set forth under “Communiqué on Procedures and Principles related to Activities of Representative Offices Established in Turkey” dated 1 April 2008 and published by Banking Regulatory and Supervision Agency. As per this Communiqué, representative offices are not permitted to engage in any profit or expense generating activities, accept deposits or participation funds, extend credits, enter into an obligation in its own name or on its behalf or engage into any other banking activities that are enumerated under Banking Law No. 5411.

IV. CO-OPERATION WITH LOCAL ENTITY

As an alternate to establishing a local entity in Turkey, co-operation with an already locally licensed financial entity (i.e. brokerage firm or asset management company) is also an option for FFIs to reach out Turkish residents. A local brokerage firm in Turkey, as part of its brokerage activity, may designate a FFI in order to transmit the orders of its clients in relation to foreign financial instruments for execution in foreign markets provided that such FFI is notified to the CMB in advance. In this scenario, FFI will be able to offer its service to Turkish clients of the referred brokerage firm without establishing a local existence in Turkey. In addition to the brokerage activity, FFI may provide its service in relation to research, analyse and asset management facilities and create a business co-operation with the local entities where it supports such local entity with its international network and broad experience.

V. CONCLUSION

Generally speaking, FFIs have an appetite for offering their service or products in Turkey, however, most FFIs may not find it cost-effective to set up a local entity in Turkey as a possible reflection of economic ambiguity of Turkey recently. However, FFIs may always cooperate with an existing local entity duly licensed by the CMB and may offer, market, promote and sell their products to Turkish residents through the intermediation of such local entity.

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